Unit-3 Business Economics

1. Meaning and Scope of Business Economics

Business Economics is playing an important role in our daily economic life and business practices. In actual practice different types of business are existing and run by people so study of Business Economics become very useful for businessmen. Since the emergence of economic reforms in Indian economy the whole economic scenario regarding the business is changed. Various new types of businesses are emerged, while taking the business decisions businessmen are using economic tools.

Business involves decision-making; and business economics serves as a bridge between economic theory and decision-making in the context of business. Economic theories, economic principles, economic laws, economic equations, and economic concepts are used for decision making.

The word "Economics" originates from the Greek Word **"Oikonomikos"** which can be divided into two parts.

- "**Oikos**" which means House and
- "**Nomos**" which means Management.

The Economic System comprises human being having variety of Wants. These wants may be classified into two basic two type.

- Economic Wants
- Non-Economic Wants.

> ***According to Mc Nair and Meriam***, *"Business economic consists of the use of economic modes of thought to analyse business situations."*
>
> ***According to E. F. Brigham and J. L. Pappas***, *"Managerial Economics is the application of Economic theory and methodology to business administration practice."*
>
> ***According to Joseph L Messey***, *"Business Economics is the use of economics theories by the Management in Marking business decision."*
>
> ***According to Hauge***, *"Managerial Economics is concerned with using logic of economics, mathematics & statistics to provide effective ways of thinking about business decision problems."*
>
> ***According to Joel Dean***, *"The purpose of Managerial Economics is to show how economic analysis can be used in formulating business policies."*
>
> *Business Economics is also known as "**Managerial Economics**". It is also known as "**Applied Economics**". Business Management means any activity undertaken to earn profit, run by a person and managed with the help of economics.*

Therefore Managerial Economics is also called Business Economics. In Managerial Economics the concepts, principles and theories in pure economic science are applied to any business activities. Therefore it is also called as Applied Economics.

Objectives of Business Firms

1. Profit Maximization : In the conventional theory of the firm, the principal objective of a business firm is profit maximization. It is prime objective of Business entity. According to this a firm prefers to produce at that point where it can make maximum of profit. To gain that level of production a firm may follow to different rules i.e. total revenue, total cost rule and marginal cost marginal revenue rule.

Profit is the difference between total Revenue and total cost. It can be calculated by deducting the total cost from total revenue.

$$\boxed{\text{Profit} = \text{Total Revenue} - \text{Total Cost}}$$

In order to maximize the profit there are two conditions which must be fulfilled in any form of market.

1. *Marginal cost must be equal to marginal Revenue.*
   i. e. MC = MR.
   This condition is called the necessary condition.
2. *Marginal cost curve must intersect Marginal revenue from below.*
   i. e. MC = MR.

2. Market Share : Business must outshine its competitors in every aspect of quality, availability, and price of goods and services. It must improve its quality of goods and services, reduce its price and improve the distribution system in order to maintain its market standing.

The basic objective of managerial economics is to analyses economic problems of business and suggest solutions and help the managers in decision-making. The objectives of business economics are outlined as below :

- To integrate economic theory with business practice.
- To apply economic concepts: and principles to solve business problems.
- To employ the most modern instruments and tools to solve business problems.
- To allocate the scarce resources in the optimal manner.
- To make overall development of a firm.
- To help in achieving other objectives of a firm like attaining industry leadership, expansion of the market share etc.
- To minimize risk and uncertainty
- To help in demand and sales forecasting.
- To help in operation of firm by helping in planning, organizing, controlling etc.
- To help in formulating business policies.

Business economics is useful because :

- It provides tools and techniques for managerial decisions.
- It gives answers to the basic problems of business management.
- It supplies data for analysis and forecasting.
- It provides tools for demand forecasting and profit planning.
- It guides the managerial economist.

Stages as Economics as Subjects

1. **Wealth Definition or Classical :** Economics as a Science of Wealth: Adam Smith

   Adam Smith systematized the concept in the form of the book which was entitled as "**An enquiry into the nature and cause of the wealth of Nations**" Published in 1776. The famous economists of this period were Adam Smith, T.R. Malthus, J.B. Say, David Ricardo, etc.

2. **Material Welfare Definition or Neo-Classical :** Economics as A science of Material welfare: A. Marshall

   Alfred Marshall Published his book **"Principle of Economics"** in 1890. The famous economists of this period were Alfred Marshall, A.C. Pigou, Carl Marx, etc. The study of economics as the satisfaction or welfare derived from the consumption of material goods.

3. **Scarcity and Choice Definition or Modern :** Economics as a Science of Scarcity and Choice : L. Robbins

   Lionel Robbins has offered most scientific definition in his famous book Published in 1932. **"An Essay on the nature and Significance of Economic Science"** The famous economists of this period were Lionel Robbins, J.M. Keynes, etc. The study of economics for changing the focus of the study is 'wealth and aspect' and 'material welfare' to 'scarcity and choice' and 'human development'.

4. **Development and Growth Definition :** Economics as a Science of Development and Growth : Paul Samuelson. He Published book **"Economics: an introductory Analysis"** first Published in 1948 was one of his famous works on economics."

Difference Between Economics and Business Economics

Economics	Business Economics
1 It is a pure Economics.	1 It is applied Economics.
2 It consists of economic theories and principles.	2 Managerial economics applies economic theories and principles to solve the business problems.
3 Economics has similar emphasis on both Micro and Macro- economics.	3 Managerial economics relatively give more stress on micro economics than macro-economics.
4 Micro economics part of Economics considers both Individual consumer as well as firm.	4 It's micro economic part considers only individual firm.
5 It's micro economic analysis deals with rent, Interest, wages and profit.	5 Micro Economic part of managerial Economics is related only with profit.

Features of Business Economics

Following are the main characteristic features of Business Economics which constitute the nature and subject matter.

(1) Business Economics means the application of economic concepts, theories and principles to the business activities.

(2) Business Economics is related with the micro-economics. It is micro in nature. It I mainly related with the problems of individual unit.

(3) Also it deals with the macro-economics. Manager of the farms has to study the macro - economic concepts like National Income, Business Cycles, Labour Relations, Government Policies on taxation, budget, monetary issues and international trade etc. By studying these macro-economic concepts Manager of a business firm takes the decisions in respect of his firm.

(4) Managerial economics deals with the theory of firm which is pure theory of economics. Economic principles of this theory are applied to his firm to decides profit. It means that managerial economics deals with the theory of distribution.

Micro and Macro Economics

It should be clear by now that economics covers a lot of ground. That ground can be divided into two parts : ***Microeconomics focuses on the actions of individual agents within the economy, like households, workers, and businesses***;

Macroeconomics looks at the economy as a whole. It focuses on broad issues such as growth of production, the number of unemployed people, the inflationary increase in prices, government deficits, and levels of exports and imports. Microeconomics and macroeconomics are not separate subjects, but rather complementary perspectives on the overall subject of the economy.

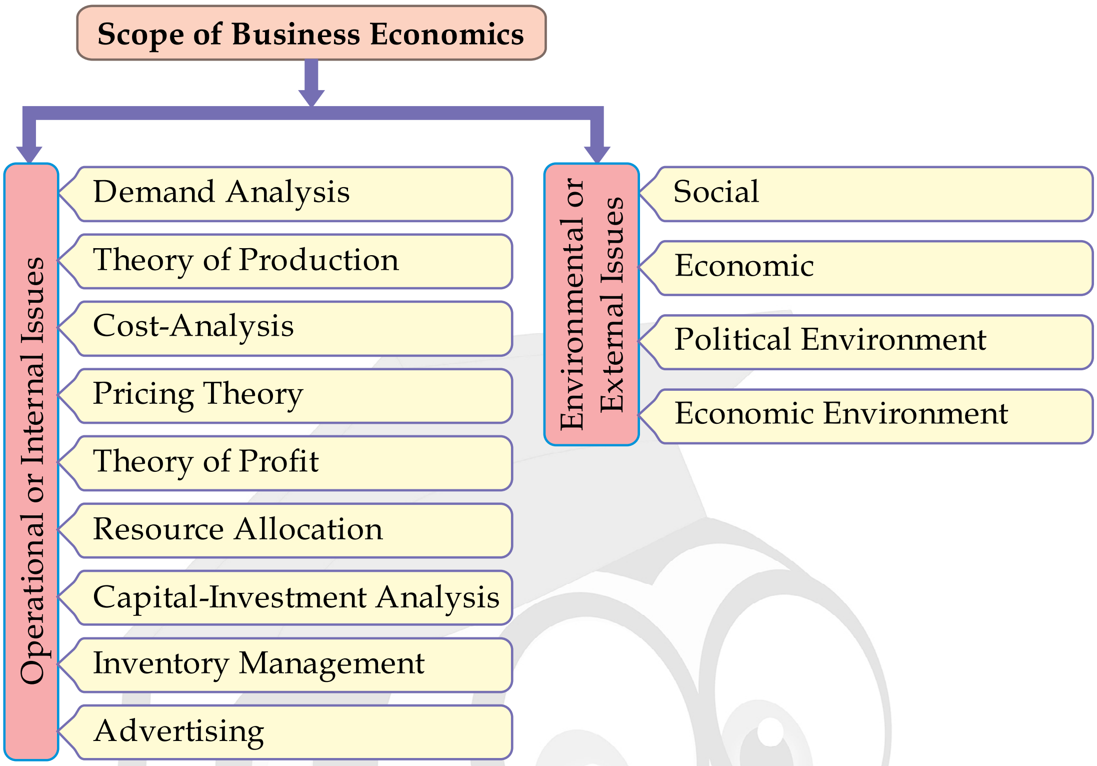
Microeconomics and macroeconomics are two different perspectives on the economy. The microeconomic perspective focuses on parts of the economy: individuals, firms, and industries. The macroeconomic perspective looks at the economy as a whole, focusing on goals like growth in the standard of living, unemployment, and inflation. Macroeconomics has two types of policies for pursuing these goals: monetary policy and fiscal policy.

Comparison between Macro-Economics & Micro-Economics

Basis for Comparison	Micro-Economics	Macro-Economics
Meaning	The branch of economics that studies the behavior of an individual consumer, firm, family is known as Microeconomics.	The branch of economics that studies the behavior of the whole economy, (both national and international) is known as Macroeconomics.
Deals with	Individual economic variables	Aggregate economic variables
Business Application	Applied to operational or internal issues	Environment and external issues
Tools	Demand and Supply	Aggregate Demand and Aggregate Supply
Assumption	It assumes that all macro-economic variables are constant.	It assumes that all micro-economic variables are constant.
Concerned with	Theory of Product Pricing, Theory of Factor Pricing, Theory of Economic Welfare.	Theory of National Income, Aggregate Consumption, Theory of General Price Level, Economic Growth.
Scope	Covers various issues like demand, supply, product pricing, factor pricing, production, consumption, economic welfare, etc.	Covers various issues like, national income, general price level, distribution, employment, money etc.
Importance	Helpful in determining the prices of a product along with the prices of factors of production (land, labor, capital, entrepreneur etc.) within the economy.	Maintains stability in the general price level and resolves the major problems of the economy like inflation, deflation, reflation, unemployment and poverty as a whole.
Limitations	It is based on unrealistic assumptions, i.e. In microeconomics it is assumed that there is a full employment in the society which is not at all possible.	It has been analyzed that 'Fallacy of Composition' involves, which sometimes doesn't proves true because it is possible that what is true for aggregate may not be true for individuals too.

Scope of Business Economics

Business Economics is mainly concerned with the application of economic principles and theories. The scope of Business economics covers two areas of decision making.



(A) Operational or Internal Issues

The manager of business firm faces the problems, which are related to the internal issues of the firm. They are controlled by the manager with the help of economic theories and principles. They are as follow :

1. **Demand Analysis :** The manager thinks about the demand for his firm's product. A firm can survive if it is able to cater the demand for its product in market at the proper time and in the right quantity. A firm can economically stand in the market, when it's goods are continuously demanded and sold in the market. Manager looks to the market demand of his firm's product. He made the accurate estimate of demand and makes the decisions. Before he come to the final conclusions manager of every business firm can study the basic concepts and theories of demand analysis in economics as law of demand, demand forecasting, elasticity of demand and their variant factors.

2. **Theory of Production : Theory of production is also called as the theory of firm.** Along with the cost of production it also consists the firm's revenue. It includes the relationship between various factors of production, input-output analysis, capital - labour ratio, optimum production, break even analysis etc. These economic concepts help to business manager in solving the problems related with the production.

3. **Cost-Analysis :** Cost of production is very significant factor in the process of production. Therefore every manager must to possess a good knowledge of cost analysis it includes various kinds of costs, which are very essential in decision making.

4. **Pricing Theories :** Managerial economics deals with the pricing theories. Pricing of a product incurs income to the firm. The success of the firm can be comprised in a sound pricing policy of its product, how the price is to be determined in various forms of market such as perfect competition, monopoly, monopolistic competition, oligopoly, duopoly etc.
5. **Theory of Profit :** Profit maximization is a aim of business firm making profit in long run is a sign of successful entrepreneur. Profit depends on various factors such as internal factors and external factors. These factors are many in number e.g. demand for product, input prices, factor prices, competition, economic policy, business risks and the amount of investment etc. Knowledge of sound profit earning policy and techniques of profit planning are also important to business manager.
6. **Resource Allocation :** Managerial economics also deals with the problem of optimum allocation of resources. Resources are scare, so they should be allocated efficiently to different uses by the manager.
7. **Capital-Investment Analysis :** Capital is scare and fundamental factor of production. It is foundation of business. Large amount of capital is invested in big firms. So many problems come up before management. In order to solve these problems enough time and labour are required. In brief, the capital budgeting involves planning and control of capital expenses.
8. **Inventory Management :** Every firm requires raw material. It would be stored in inventories. Knowledge of this stock inventory is achieved from economic theory.
9. **Advertising :** Advertising is the heart of modern business practices. It is one of the features of modern marketing system. It helps to increase the scale of a product. Therefore every businessman can follow these techniques.

(B) Environmental or External Issues

These issues are related to the general business environment in which the firm or business operates. These are social, economic and political environment's, economic environment includes kinds of economic systems, situations existing in the field of production, income, employment, prices, saving and investment, financial institutions as banks, financial corporations, Insurance companies, trends in international trade. It also includes the conditions prevailing in labour and capital markets, government policy, industrial policy, monetary policy consumer's co-operatives etc. Political environment is related to state activities. It includes the state's attitude towards business firms.

Natures of Economics

1. **Micro Economic Nature :** Business Economics is Microeconomics in nature because it deals with the matters of a particular business firm only.
2. **Use of Economic Theories :** Business Economics uses all economic theories relating to the profits, distribution of income etc.
3. **Realistic One :** Business Economics is a realistic science. It studies all matters concerning business organization by considering the real conditions existing in the business field.

4. **Normative Science :** Business Economics is a normative science. It studies the matters concerning the aims and objectives of a business firm. It determines the methods to be adopted for achieving such objectives. It also makes inquiry into the good and bad in decision making. Hence it is a normative science.

5. **Use of Macroeconomics :** Even though Business Economics has the nature of Microeconomics, it also uses Macroeconomics approaches frequently. Certain matters in Macroeconomics like business cycles, national income, public finance, foreign trade, etc. which are essential for Business Economics. So, Business Economics uses the Macro Economics phenomenon for taking business decisions.

6. **Economics as a Science :** Science is a branch of knowledge that defines the relationship between cause and effect. As results observed in science are measurable and based on facts, economics also endeavors to find a relationship between cause and effect and provides measurable results.

7. **Economics is an Art :** Art is a branch of study that deals with expressing or applying the creative skills and imagination of humans to perform a certain activity. Similarly, economics also requires human imagination for the practical application of scientific laws, principles, and theories to perform a particular activity.

Ques. *Which kind of economics explains the phenomenon of cause and effect relationship ?*

(NTA UGC-NET Dec. 2012 P-II)

(A) Normative *(B) Positive*

(C) Micro *(D) Macro*

Ans. *(B) Positive economics is a stream of economics that focuses on the description, quantification, and explanation of economic developments, expectations, and associated phenomena. It relies on objective data analysis, relevant facts, and associated figures. It attempts to establish any cause-and-effect relationships or behavioral associations which can help ascertain and test the development of economics theories.*

Ques. *Business Economics is a subject which* ***(NTA UGC-NET Dec. 2013 P-II)***

(A) studies economic relationships

(B) studies economic activities at the aggregate level

(C) deals with the tools of economics used for decision making in business

(D) studies optimum allocation of limited resources

Ans. *(C) Business Economics is a subject which deals with the tools of economics used for decision making in business*

Ques. *Which one of the following does not explain the basic nature of Business economics ?*

(NTA UGC-NET June 2014 P-II)

(A) Behaviour of firms in theory and practice.

(B) Distribution theories like rent, wages and interest along with the theory of profit.

(C) Use of the tools of economic analysis in clarifying problems in organising and evaluating information and in comparing alternative courses of action.

(D) Integration of economic theory with business practices for the purpose of facilitating decision making.

Ans. *(B) Distribution theories like rent, wages and interest along with the theory of profit does not explain the basic nature of Business economics.*

Ques. *Which one is not the item of economic cost to the business ?* ***(NTA UGC-NET June 2013 P-II)***

(A) Owner supplied resources.

(B) Market supplied resources.

(C) Implicit costs.

(D) Non-monetary opportunity costs of using owner supplied resources.

Ans. *(B) The item of economic cost to the business includes :*

1. *Owner supplied resources.*
2. *Implicit costs.*
3. *Non-monetary opportunity costs of using owner supplied resources*